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# KEEPING EMPLOYEES' TRUST: THE ROCKY ROAD AHEAD FOR PENSION PLAN TRUSTEES

NIKOLAY A. OUZOUNOV\*

Trustees are guardians of the future against claims of the present.<sup>1</sup>

## INTRODUCTION

It is not comforting to know that the average chief financial officer in the United States spends about three percent of her time managing her company's retirement accounts.<sup>2</sup> Things become even more troublesome when one considers that the liquidated value of a company's retirement accounts often exceeds the liquidated value of the company's total assets.<sup>3</sup> Recent corporate turmoil, including the facts surrounding the demise of Enron and its employee retirement plans, continues to be widely debated.<sup>4</sup>

Enron, however, was not a faceless behemoth. Observers quickly focused the spotlight on Enron's pension plans trustees.<sup>5</sup>

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\* J.D. Candidate, June 2004. I would like to thank the John Marshall Law Review Board for their patience and professionalism. I would also like to thank Tadd M. Johnson and Bob Rowe for their ideas, guidance, and expertise. Special thanks to my family in Bulgaria for their unwavering support throughout my law school career.

1. James Tobin, *What Is Permanent Endowment Income*, 64 AM. ECON. REV. 433, 434 (1974). Professor Tobin was a Sterling Professor of Economics at Yale University. For his extensive contribution to the field, Professor Tobin won a Nobel Memorial Prize in Economics in 1981. More information on Professor Tobin is available at <http://cowles.econ.yale.edu/faculty/tobin.htm>. (last visited Mar. 20, 2004).

2. Interview with Robert Rowe Jr., Founder, Rowe Decision Analytics, Chicago, Ill. (Sept. 1, 2002).

3. *Id.* See also Peter Hancock & Roberto Mendoza, *Risk and Transparency in Pensions: Roberto Mendoza and Peter Hancock Applaud UK Accounting Changes That Bring Transparency to Company Liabilities*, FIN. TIMES, Mar. 20, 2002, at 29 (commenting that defined benefit plan assets can be "a multiple of the company's market capitalization").

4. CNN's popular program Moneyline featured a daily update on the charges brought against Enron Corporation. "Enron corporate America criminal scoreboard," available at <http://www.cnn.com/CNN/Programs/moneyline/> (last visited Jan. 27, 2003).

5. Richard A. Oppel Jr., *Labor Dept. Questions Enron's Truthfulness*, N.Y. TIMES, Apr. 19, 2002, Sec. C, at 1. Oppel comments that the officers who served as pension plan trustees had information about Enron's financial

Feeling pressure from the Labor Department, Enron ousted its trustees and turned control of the pension plans over to the State Street Corporation.<sup>6</sup> Enron hardly provides the only example of trustee plan mismanagement.<sup>7</sup> Recent developments have led industry experts to believe that plan trustees, and especially trustees in charge of smaller plans, are often ill-equipped to meet their responsibilities.<sup>8</sup> Such concerns lead to the belief that we are standing on the threshold of numerous lawsuits for fiduciary breach by pension plan trustees.<sup>9</sup>

Congress has considered various legislative solutions targeted to bring a sense of security to employees in the wake of losses suffered by pension plans.<sup>10</sup> Some commentators, though, acknowledge the somewhat contradictory nature of the proposed

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hardships, but failed to act to protect employees' investments. *Id.* The value of the 401(k) plan held by Enron employees subsequently fell by more than sixty percent because the employees were primarily invested in Enron stock. *Id.*

6. *Id.* Enron switched to State Street after the Labor Department threatened a lawsuit to oust Enron's trustees. Marisa Rogoway, *Proposed Reforms to the Regulation of 401(k) Plans in the Wake of the Enron Disaster*, 6 J. SMALL & EMERGING BUS. L. 423, 424 (2002). The Enron saga is rather telling. After Enron filed for bankruptcy, the price of Enron stock plunged, and in February 2002 it was less than a dollar per share. *Id.* According to the author's research, Enron employees lost an estimate of one billion dollars in savings; these funds were mostly held in 401(k) plans. *Id.*

7. See Kathy Chen, *Are 401(k)-Plan Trustees Not Up to the Job*, WALL ST. J., May 29, 2002, at C1 (noting that Seagen Pharmaceuticals President and trustee of its 401(k) plan withheld worker's contributions and used them to pay salaries, that union pension plan trustees imprudently invested plan money with an investment-management firm which at the time was under investigation for engaging in pyramid schemes, and that First Union settled two lawsuits for alleged trustee's violations due to inadequate education). The author also discusses several other cases in which a trustee's lack of sufficient investment knowledge created serious problems. *Id.*

8. *Id.* The article comments on some troublesome practices. For example, many trustees are without a financial background, but instead are volunteers or people chosen because of their popularity within the company. *Id.* As a result, trustees are often involved in various conflicts of interest, and fail to properly fulfill their fiduciary responsibilities to plan beneficiaries. *Id.*

9. Colleen E. Medill, *Stock Market Volatility and 401(k) Plans*, 34 U. MICH. J.L. REF. 469, 470 (2001). Professor Medill voices a concern that baby boomers, soon to be retirees, may initiate a wave of litigation when they realize that they do not have enough savings to retire. *Id.* Such litigation would "eventually dwarf tobacco, firearms and other product liability litigation." *Id.* Of special concern is the fact that, for many employees, much of the security of their retirement is dependent on the performance of their employer-sponsored 401(k) plans. *Id.*

10. Congress considered several pieces of proposed legislation, including the Retirement Security Advice Act of 2002, S. 1978, 107th Cong. (2002); the Pension Protection and Diversification Act of 2001, S. 1838, 107th Cong. (2001); and the Independent Investment Advice Act of 2001, S. 1677, 107th Cong. (2001).

legislation.<sup>11</sup> To many present fiduciaries, as well as plan participants and beneficiaries, such observations add to the already complex and confusing situation.<sup>12</sup>

This Comment argues that although existing law, specifically the Employment Retirement Income Security Act of 1974 ("ERISA"), has defined various responsibilities for plan trustees, the law has insufficient provisions for plan trustees' education and expertise.<sup>13</sup> Such deficiencies are ultimately detrimental to pension plans,<sup>14</sup> their participants, and their beneficiaries. A higher standard of trustee accountability, together with adequate levels of trustee education, with an emphasis on the full scope of trustee responsibilities, are needed to better safeguard pension

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11. Albert B. Crenshaw, *Panel Approves Pension Bill; Senate Committee Plan Could Clash With House Bill*, WASH. POST, Mar. 22, 2002, at EO1. Crenshaw comments that the House and the Senate have worked independently on packages of retirement plan changes. *Id.* He points out that "if both measures are passed by their respective chambers in their current forms, the stage will be set for a tough ideological conflict when a conference committee seeks to meld them." *Id.* One difference between the packages is that the Senate bill calls for inclusion of workers as trustees of the retirement plans at large companies, while the House bill has no such requirement. *Id.*

12. Dana M. Muir, *The Dichotomy Between Investment Advice and Investment Education: Is No Advice Really the Best Advice?* 23 BERKLEY J. EMP. & LAB. L. 1, 18 (2002). Muir writes, "both behavioral economics theory and plan investment data indicate that individual employees face numerous challenges in making investment allocation decisions." *Id.* This problem, according to the author, is further intensified by employers' fears that by providing investment advice, the employer becomes a possible target of a breach of fiduciary duty suit. *Id.* at 50. *See also* Testimony of David Certner (pointing out that even before the recent events, too many investors lacked the time and knowledge and to sort through the huge quantities of available information, and make an intelligent decision), at [http://www.house.gov/ed\\_workforce/hearings/106th/eer/erisa31000/certner.htm](http://www.house.gov/ed_workforce/hearings/106th/eer/erisa31000/certner.htm). (last visited Mar. 4, 2004).

13. Chen, *supra* note 7, at C1. Chen points out that ERISA does not require pension plan trustees to have any investment expertise. *Id.* Such a low threshold for plan trustees allows any volunteer, regardless of her knowledge in investments, to become a trustee. *Id.*

14. Regina T. Jefferson, *Rethinking the Risk of Defined Contribution Plans*, 4 FLA. TAX REV. 607, 610-12 (2000). Pension plans are generally divided into two separate categories: defined contribution plans and defined benefit plans. *Id.* The main difference is in the structure of the two plans. *Id.* A defined benefit plan "pools assets" in an aggregate trust and promises to pay a fixed amount to plan participants once they retire. *Id.* The amount of money is not dependant on investment performance. *Id.* A defined contribution plan differs in its lack of an aggregate trust that pools assets. *Id.* With defined contribution plans, every participant has an individual account. *Id.* When the participant retires she receives the entire account balance. *Id.* Whether the employee will have sufficient funds for her retirement depends on the investment performance of her plan. *Id.* With the defined benefit plan, it is the employer who is liable if the employee has insufficient funds at retirement; in a defined contribution plan, where the employee has investment control, the participant bears this risk. *Id.*

plan assets.

Part I of this Comment gives an overview of ERISA as it pertains to retirement plan trustees. This Part will focus on (1) the fiduciaries designated by ERISA, (2) the fiduciary duties created by ERISA, (3) the penalties for failure to meet fiduciary duties prescribed by ERISA, and (4) ERISA's relevance to pension plan trustees. Part II of this Comment analyzes trustees' frequent lack of knowledge regarding investments, and the resulting detrimental effect on pension plan assets. Part III proposes some possible solutions, specifically that ERISA should require that trustees (1) possess sufficient information about their duties as fiduciaries, and (2) have a minimum level of investment knowledge that would enable them to oversee plan assets and the actions of investment advisors.

### I. BACKGROUND: THE ORIGINS OF TRUSTEE DUTIES UNDER ERISA

ERISA was enacted to protect plan participants and beneficiaries from mismanagement of funds and employer abuse.<sup>15</sup> ERISA's objective was to ensure that sufficient funds were available for payment of promised pension plan benefits.<sup>16</sup> ERISA also provided that plan participants must be given sufficient information about their employee benefit plans,<sup>17</sup> and created a set of responsibilities for plan trustees "by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee

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15. 29 U.S.C. § 1001(a) (2000). The United States Supreme Court in *Varity Corp. v. Howe* explained that the purpose of ERISA is to protect "employee pensions and other benefits by providing insurance . . . specifying certain plan characteristics in detail . . . and by setting forth certain general fiduciary duties." 516 U.S. 489, 496 (1996). See also Susan J. Stabile, *Freedom to Choose Unwisely: Congress' Misguided Decision to Leave 401(k) Plan Participants to Their Own Devices*, 11 CORNELL J. L. & PUB. POLY 361, 366 (2002) (giving a detailed account of the policy and considerations behind ERISA). Stabile states that the need for protection from employer abuse is in its essence protection from employer overreaching. *Id.* Because employees have weaker bargaining power they need protection from the "opportunistic behavior" of a party with superior bargaining power. *Id.*

16. 29 U.S.C. § 1001(a). This section enumerates a long list of general policy considerations, some of which state that until the enactment of ERISA many employees with long years of employment are losing anticipated retirement benefits owing to the lack of vesting provisions in such plans; that owing to the inadequacy of current minimum standards, the soundness and stability of plans with respect to adequate funds to pay promised benefits may be endangered; that . . . employees and their beneficiaries have been deprived of anticipated benefits.

*Id.*

17. 29 U.S.C. § 1001(b) (2000). ERISA states that its purpose is to protect "the interests of participants in employee benefit plans and their beneficiaries, by requiring the disclosure and reporting to participants and beneficiaries of financial and other information." *Id.*

benefit plans, and by providing for appropriate remedies.”<sup>18</sup>

*A. Who Bears the Burden of Fiduciary Responsibility?*

ERISA does not specifically describe the roles of pension plan trustees.<sup>19</sup> However, ERISA clearly describes what parties are to act as fiduciaries, and what their roles are.<sup>20</sup> ERISA designates as plan fiduciaries parties who exercise “discretionary control” with respect to management of the plan or exercise “any authority or control respecting management or disposition of its assets.”<sup>21</sup>

Paid investment advisors are the clearest example of plan fiduciaries.<sup>22</sup> Employers who provide investment information and education that amounts to investment advice can also be designated as fiduciaries.<sup>23</sup> The law allows an employer who hires a professional investment advisor to delegate his fiduciary duty for making investment decisions to the advisor.<sup>24</sup> The employer, however, “retains fiduciary liability for the selection and monitoring of the investment manager.”<sup>25</sup>

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18. *Id.* See also *Varity Corp.*, 516 U.S. at 496 (noting that ERISA serves its purpose by creating a set of “general fiduciary duties applicable to the management of both pension and nonpension benefit plans”).

19. See 29 U.S.C. § 1002 (2000) (containing definitions of the terminology used in the statute).

20. See *id.* § 1002(21) (listing the requirements that create a fiduciary relationship and subsequent duties).

21. *Id.* § 1002(21)(A)(i). The statute also designates as fiduciary a party that “renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so.” *Id.* § 1002(21)(A)(ii).

22. *Id.* § 1002(21). Investment advisors who receive compensation for their services will fall under 29 U.S.C. § 1002(21) as parties that render investment advice for a fee. *Id.*

23. See *Muir*, *supra* note 12, at 3 (arguing that current law discourages employers from providing individual employees who manage their accounts with investment advice). This anomaly is due to the distinction between investment education and investment advice. *Id.* Employers are reluctant to engage in “investment advice” and become fiduciaries and thus subject themselves to potential liability to the plan participants and beneficiaries. *Id.*

24. *Id.* at 9.

25. *Id.* The reasoning behind the rule is that even when the employer has selected an investment advisor, the employer retains his status as fiduciary because he exercises control in the process of selection of the advisor and oversees the performance of the investment advisor. See *Stabile*, *supra* note 15, at 364 (arguing that even with 401(k) plans, an employer has sufficient control over the choices of the plan participants). Professor *Stabile* relies on behavioral theorists to establish that although 401(k) plan participants seemingly make their own investment decisions, “the actual choices presented and how those choices are presented has a tremendous impact on participant decision-making.” *Id.* The author concludes that the effect of context-dependence is that plan-participant “control” is illusory. *Id.* at 363.

### B. What are the Trustees' Duties under ERISA?

The trustees' duties under ERISA are rooted in the state common law of trusts.<sup>26</sup> The heart of trustee duty is the concept of prudence, a requirement that can be traced back to the seminal case of *Harvard College v. Amory*.<sup>27</sup> The *Amory* Court stated that trustees should "observe how men of prudence, discretion and intelligence manage their own affairs . . . in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested."<sup>28</sup> This language was codified in the Model Prudent Man Rule Statute.<sup>29</sup> Later, a similar standard of prudence, the "Prudent man standard of care," was written into the statutory language of ERISA.<sup>30</sup> Most recently, this reasonable person standard was placed in the heart of the Uniform Prudent Investment Act of 1995.<sup>31</sup>

Apart from the reasonable person standard, ERISA imposes additional duties on plan trustees. These duties include the duty to act "solely in the interest of the [plan] participants and

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26. *Varity Corp.*, 516 U.S. at 496 (stating that "we recognize that these fiduciary duties draw much of their content from the common law of trusts, the law that governed most benefit plans before ERISA's enactment."). The Court quotes its ruling in *Central States, Southeast & Southwest Areas Pension Fund v. Central Transport, Inc.*, 472 U.S. 559, 570 (1985), stating that instead of explicitly enumerating the powers and duties of trustees, Congress relied on the common law of trusts to establish the boundaries of trustee responsibilities. *Id.* See also Jefferson, *supra* note 14, at 620-21 (stating that state common law of trusts and the Internal Revenue Code was used to govern trustee conduct before adoption of ERISA in 1974).

27. See *Harvard College v. Amory*, 26 Mass. (9 Pick.) 446 (1830) (articulating the prudent man standard).

28. *Id.* at 461.

29. For a more detailed discussion, see *infra* notes 30 and 31, and corresponding text.

30. 29 U.S.C. § 1104(a) (2000). ERISA provides that a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and . . . with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity . . . would use in the conduct of an enterprise of a like character and with like aims . . . .

*Id.*

31. UNIF. PRUDENT INV. ACT § 1 (1995). The Uniform Prudent Investor Act addresses some of the most painful problems facing pension plan trustees. The Act defines the prudent man rule as it applies to investments. *Id.* § 1. Even more importantly, the Act focuses on the trustee's standard of care, the establishment of overall investment strategy and other relevant considerations (economic conditions, the effect of inflation, tax considerations, how each investment fits within the overall trust portfolio, expected return, etc.). *Id.* § 2. The Act also dedicates a whole section to diversification, closely following the diversification requirement in the Restatement (Second) of Trusts as well as ERISA. *Id.* § 3.

beneficiaries,"<sup>32</sup> as well as the duty to act with the "exclusive purpose of providing benefits to participants and their beneficiaries."<sup>33</sup> Plan trustees also have a duty to diversify plan investments in order to minimize potential losses due to unfavorable market conditions.<sup>34</sup> This Comment will specifically address diversification of assets because of its importance to pension plans' financial health.<sup>35</sup> Finally, ERISA also requires that "no fiduciary may maintain the indicia of ownership of any assets of a plan outside the jurisdiction of the district courts of the United States."<sup>36</sup>

### C. Liability for Failure to Comply with ERISA Standards

ERISA prescribes liability for failure to live up to the standards set forth in section 404.<sup>37</sup> In addition, ERISA establishes a set of prohibited transactions, which, if undertaken, create a presumption that the fiduciary is not acting in the best interest of the plan.<sup>38</sup> These prohibited transactions fall into two

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32. 29 U.S.C. § 1104(a)(1) (2000). Plan fiduciaries must strictly abide by the provisions set in the plan documents, as well as inform plan participants and beneficiaries of material facts which may notify them of potential risks in the plan. Rogoway, *supra* note 6, at 425. Professor Medill takes a closer look at the fiduciary duties of loyalty, prudence, and diversification in relation to 401(k) plans specifically. Medill, *supra* note 9, at 476. Of peculiar interest is her observation that the duty of diversification creates an obstacle to participant directed investments such as 401(k) plans. *Id.* Because 401(k) plans allow employees to have a voice in how their retirement funds are invested, participants often do not select a diversified range of investments. *Id.*

33. ERISA § 404; 29 U.S.C. § 1104(a)(1)(A)(i) (2000); *see also* Susan J. Stabile, *Breach of ERISA Fiduciary Responsibilities: Who is liable anyway?* 5 EMPL. RTS. & EMPLOY. POLY J. 135, 138-39 (2001) (discussing the general standards of fiduciary responsibilities as they are defined in ERISA §§ 404 and 406). Professor Stabile pays specific attention to the two types of prohibited transactions under § 406. *Id.*

34. 29 U.S.C. § 1104(a)(1)(C) (2000). The requirement for diversification originates from the common law of trusts. *See supra* note 31 and accompanying text (discussing diversification as addressed by the UNIF. PRUDENT INV. ACT and the RESTATEMENT (SECOND) OF TRUSTS).

35. Chen, *supra* note 7, at C1. Diversification is where many trustees fail because of inadequate investment knowledge, or because they are unaware that they are legally responsible for the sufficient diversification of the plan. *Id.* In Enron's case, plan participants had invested their savings primarily in Enron stock, which led to huge losses when Enron stock price fell. *Id.*

36. 29 U.S.C. § 1104(b) (2000).

37. These are the standards of prudence and the standard to act solely in the interest of the plan as addressed by Professor Stabile, *supra* note 15, at 361 n1.

38. 29 U.S.C. § 1106 (2000). When a pension plan fiduciary engages in prohibited transactions, she can be held personally liable subject to the guidelines established under ERISA section 502. *Id.* § 1109. One example of a prohibited transaction is the extension of credit from the pension plan to the employer; another example is not making effort to collect delinquent



categories.<sup>39</sup> The first category includes transactions between fiduciaries and the plan that indicate self-dealing.<sup>40</sup> The statute mandates that a fiduciary shall not

(1) deal with the assets of the plan in his own interest or for his own account, (2) in his individual or in any other capacity act in any transaction involving the plan on behalf of a party . . . whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries, or (3) receive any consideration for his own personal account from any party dealing with such plan in connection with a transaction involving the assets of the plan.<sup>41</sup>

The second category includes transactions between the pension plan and parties-in-interest<sup>42</sup> to the plan.<sup>43</sup> These types of prohibited transactions may range from the “sale or exchange, or leasing of any property, between the plan and a party in interest” to the “furnishing of goods, [and] services.”<sup>44</sup>

Section 409(a) of ERISA establishes liability for violation of sections 404 and 406 of the statute.<sup>45</sup> Specifically, the statute prescribes that any fiduciary “who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries . . . shall be personally liable to make good to such plan any losses to the plan resulting from each such breach.”<sup>46</sup> Fiduciaries may be subject to case-specific liabilities, including removal from the position they held at the time of the breach.<sup>47</sup> The actual

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contributions to the plan. *Liss v. Smith*, 991 F. Supp. 278, 289-90 (S.D.N.Y. 1998). See also *Stabile*, *supra* note 33, at 148-49 (elaborating on the statutory relationship between ERISA §§ 406 and 502).

39. *Stabile*, *supra* note 33, at 139.

40. *Id.*

41. 29 U.S.C. § 1106(b) (2000). Some courts have held that prohibited transaction claims under § 406 cannot be made independently from a general fiduciary breach claim. *Castaneda v. Baldan*, 961 F. Supp. 1350, 1356-57 (S.D. Cal. 1997).

42. 29 U.S.C. § 1002(14) (2000). A party in interest to an employee retirement plan can be “any fiduciary . . . counsel or employee of such employee benefit plan; . . . a person providing service to such plan; [or] . . . an employee organization any of whose members are covered by such plan . . .” *Id.*

43. *Stabile*, *supra* note 33, at 139.

44. 29 U.S.C. § 1106(a) (2000).

45. *Id.* § 1109(a).

46. *Id.*

47. *Id.* § 1111(a). The statute identifies people who have committed certain crimes ranging from robbery to crimes involving abuse of position leading to “illegal gain at the expense of the members of the labor organization or the beneficiaries of the employee benefit plan.” *Id.* § 1111(b). Penalties can be severe, with a maximum of five years imprisonment or fines up to \$10,000. *Id.* § 1105. Additionally, ERISA § 405 imposes liability on fiduciaries for breach by a co-fiduciary. *Id.* See also *Stabile*, *supra* note 33, at 140 (discussing different scenarios that fall under 29 U.S.C. § 1105, such as when “a fiduciary knowingly participates in a breach by another fiduciary, enables another

enforcement provisions for criminal and civil fiduciary breach are contained in sections 501 and 502, respectively.<sup>48</sup>

The application of ERISA's broad powers was exemplified in a recent United States Supreme Court decision, *Varity Corporation v. Howe*.<sup>49</sup> In *Varity*, the Supreme Court upheld an Eighth Circuit ruling that Varity had breached its fiduciary obligations to the beneficiaries of its retirement plan because it failed to administer the plan solely in the interest of the beneficiaries.<sup>50</sup> The Court held that Varity, which was both an employer and a plan administrator, acted as a fiduciary when it made misrepresentations regarding its employee benefits plan to the plan participants.<sup>51</sup> The Court further held that Varity breached its fiduciary duty to act solely in the interest of the plan beneficiaries.<sup>52</sup> Varity had reassured the participants that their funds would be secure if they transferred them to a newly incorporated Varity subsidiary, when, in fact, the new entity was experiencing serious financial difficulties.<sup>53</sup>

Although cases like *Varity* (where the trustees knowingly misled plan participants) do occasionally occur,<sup>54</sup> it is much more common to encounter lawsuits arising out of allegations that plan trustees are completely or partially unqualified to fulfill their duties as fiduciaries.<sup>55</sup> This type of fiduciary breach is often due to the trustee's lack of investment knowledge, which (in cases with smaller plans) is sometimes exhibited on a rather elementary

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fiduciary to commit a fiduciary breach by his own failure to live up to his fiduciary responsibilities or fails to make reasonable efforts to remedy a breach by another fiduciary . . .").

48. 29 U.S.C. §§ 1131-1132 (2000). The first part of the statute, subsection 502(a), establishes who has standing to sue for alleged fiduciary violations. *Id.* § 1132(a). The statute "empower[s]" plan participants, beneficiaries, and even other fiduciaries to sue. *Id.* The following subsections deal with specific situations such as delinquent contributions, and a fiduciary's failure to supply requested information or to provide an annual report. *Id.* § 1132 (b)-(c).

49. *Varity Corp.*, 516 U.S. at 489.

50. *Id.* at 491.

51. *Id.* at 498. The Court agreed with the District Court that "Varity was wearing its 'fiduciary,' as well as its 'employer,' hat." *Id.*

52. 29 U.S.C. § 1104(a)(1) (2000).

53. *Varity Corp.*, 516 U.S. at 493-94. In fact, as the lower court established, the subsidiary was insolvent from the very beginning. *Id.* at 494. The ERISA fiduciary duty includes the common-law duty of loyalty. *Id.* at 506.

54. Susan J. Stabile, *Another Look at 401(k) Plan Investments in Employer Securities*, 35 J. MARSHALL L. REV. 539, 559-61 (2002). Professor Stabile discusses allegations that Enron fiduciaries knowingly withheld key information regarding the company's financial health from plan participants. *Id.* at 559-60. The author also discusses a situation at Lucent Technologies in which participants alleged that "executives tried to persuade company employees to invest their plan assets in company stock, even though they knew the company was in a serious financial trouble." *Id.* at 560-61.

55. Chen, *supra* note 7, at C1.

level.<sup>56</sup> The following section will therefore analyze the detrimental effects to retirement plans caused by plan trustees' lack of knowledge and expertise.

## II. JUDICIAL TREATMENT OF THE PRACTICAL AND THEORETICAL PROBLEMS OF PENSION PLAN TRUSTEE PERFORMANCE.

Many present day trustees, especially those in charge of smaller plans, are part-time volunteers<sup>57</sup> with full-time responsibilities<sup>58</sup> that directly affect the lives of millions of plan participants.<sup>59</sup> The first part of this Comment may have created the impression that a trustees' task is not incredibly challenging: trustees simply have to act reasonably and loyally to the plan and its participants.<sup>60</sup> How then is it possible that so often pension plan trustees find themselves in fiduciary breach?<sup>61</sup>

To answer this question, this Comment will identify and analyze some frequently litigated areas of trustee fiduciary breach. This part of the Comment will also consider what steps must be taken to prepare fiduciaries to meet their responsibilities more adequately.

Acting prudently<sup>62</sup> and for the sole interest of the plan<sup>63</sup>

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56. See *id.* (giving an example of a trustee at a well-known bank who "didn't know the difference between the S&P 500 and the Fortune 500"). See also *Liss*, 991 F. Supp. at 289-303 (describing various allegations against pension plan trustees).

57. Chen, *supra* note 7, at C1. The author points out that trustees are elected not according to their expertise in investment and finance, but according to their popularity within the organization. *Id.*

58. See Jefferson, *supra* note 14, at 621-22 (discussing the origins of trustees' duties and the "prudent man standard" under the common law of trusts). After the adoption of ERISA in 1974, common trust law became the starting point for more specified duties. *Id.* at 621. Although ERISA focuses on fiduciary duties in general, a corresponding regulation specifies that trustees, with certain limited exceptions, "shall have exclusive authority and discretion to manage and control the assets of the plan." 29 C.F.R. § 2550.403a-1(c) (2002). Trustees have a high level of responsibility as plan fiduciaries, and therefore must observe investment duties as specified under 29 C.F.R. § 2550.404a-1 (2003).

59. Stabile, *supra* note 54, at 545 n.27. The author cites a number of authorities to show the growth of assets in 401(k) plans, specifically showing that at present, 401(k) plans have about \$2 trillion in assets and cover more than 42 million participants. *Id.*

60. See Medill, *supra* note 9, at 476 (discussing the duties of loyalty and diversification).

61. See *id.* (warning of a possible wave of fiduciary breach litigation in the near future, due largely to the existence of many under-funded plans).

62. See 29 U.S.C. § 1104(a) (2000) (establishing the general fiduciary duties of prudence and diligence). See also *Varity Corp.*, 516 U.S. at 496 (mentioning that in enacting ERISA, Congress did not specifically enumerate trustee duties, but relied on the common law of trusts).

63. Medill, *supra* note 9, at 500.

requires more than what ERISA section 1104(a) suggests on its face. In fact, trustee duties under ERISA are not only numerous, but they are also, as the Second Circuit stated, "the highest known to the law."<sup>64</sup> Some trustee responsibilities include the duties to investigate fund investments, diversify the plan's investments, adhere to investment policy statements, monitor pension plan solvency, and actively oversee the work of the plan's investment advisor.<sup>65</sup>

#### A. Duty to Investigate Investments

Statutory language<sup>66</sup> and court decisions have established that trustees have a duty to investigate the safety of plan investments.<sup>67</sup> Common trust law and ERISA section 404 provide that trustees should act according to a standard of prudence.<sup>68</sup> The Third Circuit in its recent decision, *In Re Unisys Savings Plan*, noted that, apart from the duty to diversify,<sup>69</sup> the standard of prudence requires trustees to exercise due care<sup>70</sup> in their dealings with the plan. One of the central elements of due care, the court pointed out, requires that trustees must "investigate the safety of the investment and its potential for income by securing reliable information" and consulting with qualified experts.<sup>71</sup> The opinion of the Eighth Circuit in *Roth v. Sawyer-Cleator Lumber Co.* defined similar trustee requirements,<sup>72</sup> stating that the prudent person requirement necessitates that the trustee investigate the safety of the plan's investments.<sup>73</sup>

*Liss v. Smith* exemplifies the harsh consequences of failing to investigate investment decisions.<sup>74</sup> In *Liss*, defendant plan trustees had to respond to a large number of allegations<sup>75</sup> based

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64. *Donovan v. Bierwirth*, 680 F.2d 263, 272 n.8 (2d Cir. 1982).

65. See *Liss*, 991 F. Supp. at 291-303 (addressing a number of grounds for trustee fiduciary breach, such as failure to collect delinquent contributions, failure to follow investment policies and guidelines, failure to hire an investment advisor, failure to investigate plan investments, and failure to diversify plan assets).

66. See 29 U.S.C. § 1104(a) (2000) (explaining the duty to act as a prudent person).

67. See *Roth v. Sawyer-Cleator Lumber Co.*, 16 F.3d 915, 917 (8th Cir. 1994) (explaining the duty to investigate plan investments and to diversify assets).

68. See *In re Unisys Savings Plan Litig.*, 74 F.3d 420, 434-45 (3d Cir. 1996) (providing a thorough analysis of the prudent person standard under the common law as well as under ERISA).

69. *Id.* at 434.

70. *Id.*

71. *Id.*

72. *Roth*, 16 F.3d at 915.

73. *Id.* at 917, 919.

74. *Liss*, 991 F. Supp. at 278.

75. *Id.* at 286. The main allegations were failure to collect delinquent plan

on, as the court put it, the trustees' "astounding naiveté evidencing a lack of basic investment technique[] and knowledge."<sup>76</sup> One of the trustees, it was alleged, failed to investigate or even inquire into the investment of plan assets.<sup>77</sup> The trustees relied blindly on their broker, investing, solely on his word, up to twenty-five percent of the total plan assets at a time.<sup>78</sup> The trustees also failed to inquire into the "merit, structure and prudence of the various investments they made."<sup>79</sup> The Court found that the trustees were in fiduciary breach, and specifically emphasized that such behavior was "[p]articularly shocking."<sup>80</sup>

### B. Diversification of Assets

Diversification of assets is another area with crucial importance for plan performance; this issue has been the subject of frequent litigation.<sup>81</sup> Diversification of plan assets is expressly required under the law.<sup>82</sup> Failure to diversify is one of the most common problems that pension plan trustees encounter.<sup>83</sup> Although the story of Enron is rather telling,<sup>84</sup> it does not explain

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contributions, lack of investment policy, failure to conduct independent investigation into the safety of investments, and failure to use due care in selecting a plan provider. *Id.* at 285-88. Common to all these claims was the allegation that the trustees lacked "the requisite knowledge, experience and expertise" to properly fulfill their duties. *Id.* at 297.

76. *Id.*

77. *Id.* at 298. The court noted that trustees made investments of substantial portions of the plan assets "based solely on the advice of a broker, whose credentials they never reviewed." *Id.*

78. *Id.*

79. *Id.* at 299.

80. *Id.*

81. Stabile, *supra* note 54, at 539. The author examines the reasons for 401(k) plan over-investment in employer securities. *Id.* Some employees, although aware of the dangers of lack of diversification, tend to invest in employer stock because of their sense of loyalty to their company; other employees have an optimistic bias because they are overly confident that their company will perform well; other reasons may be peer pressure at the workplace or context-dependence (an employee is "context-dependent" if she is limited and controlled in her investment decisions by the choices presented to her). *Id.* at 547-52.

82. 29 U.S.C. § 1104(a)(1)(C) (2000).

83. See Stabile, *supra* note 54, at 542-43 (discussing in detail the lack of diversification in 401(k) plans due to over-investment in employer securities). Professor Stabile points out that when 401(k) plans offer employer stock options, eighty to ninety percent of the plan assets may be invested in employer securities. *Id.* This high number is more predominant with low-wage workers who rely more heavily on their 401(k) plans as sources of retirement income. *Id.*

84. *Id.* at 559-60. Because of its magnitude, the Enron debacle deserves special attention. Enron's retirement plans were an example of heavy investment in employer securities. *Id.* According to Professor Stabile, of those employees who had 401(k) plans, about sixty percent of the plan was invested

why plan trustees repeatedly fail to follow this requirement. One of the reasons for some trustees' failure in this regard is their lack of adequate financial background, which often leads to unjustifiably heavy investments in a single security.<sup>85</sup> This problem has persisted for some time, and has been addressed not only by the courts, but also by legal commentators.<sup>86</sup>

A telling example of over-investment is *Brock v. Citizens Bank of Clovis*.<sup>87</sup> In *Brock*, defendant plan trustees at a bank received a warning from the Department of Labor that they were in violation of ERISA's diversification requirement for investing eighty-five percent of the plan assets in commercial real estate mortgages.<sup>88</sup> Trustees did not take any action, but claimed that the investments were prudent and sufficiently diversified.<sup>89</sup> The Tenth Circuit held that the plan trustees had breached ERISA's diversification requirement because the "trustees had chosen to invest in 'one type of security,' which did not protect against a multitude of risks."<sup>90</sup> Similarly, in *Dardaganis v. Grace Capital Inc.*, the Second Circuit held that section 404 of ERISA imposes on trustees the specific duty to diversify investments in order to minimize risks.<sup>91</sup> The court further noted that failure to meet the

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in Enron stock. *Id.* While Enron stock was plummeting, many retirement plan participants lost seventy to ninety percent of their retirement assets, which for some participants amounted to hundreds of thousands of dollars. *Id.* The situation was further aggravated by a freezing period during which employees were prevented from switching out of company stock. *Id.* The huge losses led to investigation by the Department of Labor, and class-action lawsuits on behalf of plan participants. *Id.* Professor Stabile gives another example of the lack of diversification presented by another well-known business name, Lucent Technologies. *Id.* at 560-61. In Lucent's case, the company stock fell more than ninety percent over a period of eighteen months. *Id.* Many plan participants who were heavily invested in Lucent's stock lost significant amounts of retirement assets. *Id.*

85. *Id.*

86. *Id.*

87. *Brock v. Citizens Bank of Clovis*, 841 F.2d 344 (10th Cir. 1988).

88. *Id.* at 346.

89. *Id.*

90. *Id.* See also Stabile, *supra* note 54, at 559 (describing Enron's staggering losses, where some plan participants lost between seventy to ninety percent of the value of their retirement accounts, which in some cases translated into hundreds of thousands of dollars).

91. *Dardaganis v. Grace Capital Inc.*, 889 F.2d 1237, 1242-43 (2d Cir. 1989). *Dardaganis* involved a suit against an investment adviser hired by an employee benefits plan, who failed to abide by the plan documents that set a limit to common stock investments. *Id.* at 1239-42. Specifically, the plan required that "[c]ommon stocks held shall not exceed 25% of the cost of the securities in the Account." *Id.* at 1239. Over the next three years the proportion periodically increased until it reached eighty percent, at which point the investment advisor was fired by the plan. *Id.* The Court found the investment advisor liable for failure to abide by the plan documents that aimed to maintain a minimum level of asset diversification. *Id.* at 1243.

diversification requirement results in fiduciary liability separate from liability for imprudent actions.<sup>92</sup>

### C. Investment Advisors

ERISA does not explicitly require trustees to hire investment advisors,<sup>93</sup> but court decisions indicate that hiring investment advisors falls within the prudent person standard of care. *Katsaros v. Cody* illustrates the importance of dealing with an investment advisor.<sup>94</sup> In *Katsaros*, defendant plan trustees were responsible for approving a loan for the purchase of land and a gambling casino,<sup>95</sup> as well as for approving a loan to a bank, which was soon thereafter closed by federal regulatory officials.<sup>96</sup> The court removed the trustees from their positions and ordered them to compensate the plan for the losses suffered.<sup>97</sup> The court held that because the trustees were "ill-equipped to evaluate the soundness of the proposed loan" they had breached their fiduciary duty by failing to procure outside assistance.<sup>98</sup> None of the trustees had banking or accounting backgrounds, and they were therefore wholly unprepared to analyze the financial information presented to them.<sup>99</sup> The court went on to state that the trustees' lack of investment knowledge and expertise was not an excuse under an objective inquiry pursuant to ERISA.<sup>100</sup> The reason for such a policy lies in the common law trust requirement that a prudent person will be judged according to the standard of a "prudent man . . . familiar with such matters" and acting in a similar capacity.<sup>101</sup> The court noted that the defendants had an opportunity to use the services of an advisor who was well equipped to evaluate the risk of the loans in question.<sup>102</sup>

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92. *Id.* at 1241. See also *Liss*, 991 F. Supp. at 301 (discussing plaintiffs' suit against plan trustees for fiduciary breach alleging, among other things, failure to diversify investments).

93. *Liss*, 991 F. Supp. at 296.

94. 744 F.2d 270 (2d Cir. 1984).

95. *Id.* at 274.

96. *Id.* at 275-76.

97. *Id.* at 280-82.

98. See *id.* at 279 (noting that trustees relied only on the borrower's representations without considering another opinion as to the soundness of the loan).

99. See *Liss*, 991 F. Supp. at 296-97 (comparing the trustees' problems in *Katsaros* to those presently alleged before the Court).

100. See *Katsaros*, 744 F.2d at 279 (citing *Marshall v. Glass/Metal Ass'n*, 507 F. Supp. 378, 384 (D. Haw. 1980)).

101. 29 U.S.C. § 1104(a)(1)(B) (2000).

102. *Katsaros*, 744 F.2d at 279-80. For example, although the witness called by the Government did not have pension plan management experience, the issue was narrower: "namely whether a loan to a bank or bank holding company was a prudent investment." *Id.* at 279. The Government's expert "was fully qualified . . . to testify on that basic issue and brought his expertise

Courts have generally held that when a trustee lacks the necessary education and expertise, the trustee has a duty to seek independent advice.<sup>103</sup> What is important, though, is that the services of an independent advisor or an expert do not shield the trustee from liability.<sup>104</sup> The law designates the trustee as the person who has to make the final decision based on pertinent information and outside advice.<sup>105</sup> It is evident that an uneducated trustee would not be able to evaluate such advice independently, but would have to blindly follow the advice of others and hope for fortunate results. Such a situation puts the plan's assets at risk, and is against the Congressional policy that gave birth to ERISA as evidenced in 29 U.S.C. § 1001(a).<sup>106</sup> Retirement plan security should not depend upon the decisions of ill-qualified trustees.<sup>107</sup>

#### D. Investment Policy Statements

Another important area of trustee litigation is compliance with written investment policy statements. This aspect of trustee responsibility is closely related to diversification, in that trustees have a fiduciary responsibility to comply with written investment statements in the process of overseeing the plan.<sup>108</sup> The relevant

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to bear through his analyses based on generally accepted ratios such as profitability, adequacy of capital, and liquidity." *Id.* at 279-80.

103. *United States v. Mason Tenders*, 909 F. Supp. 882, 886-87 (S.D.N.Y. 1995). The suit against two pension plan trustees alleged fiduciary breach in the purchase of two pieces of real estate property. *Id.* at 886. The facts establish that the trustees paid \$24 million for a piece of property, "which was \$16.5 [million] more that the seller had paid for the building less than ten months earlier." *Id.* at 884. Additionally, the plaintiffs allege that less than a year after the \$24 million purchase, an independent comprehensive analysis showed that the building was worth only \$5 million. *Id.* at 887. The building was in fact worth \$5 million only after the fund had spent a substantial amount of money for renovations. *Id.* The court found fiduciary breach because the trustees never obtained an appraisal as required by the plan insurance policy. *Id.* at 888. The trustees also failed to engage in an independent investigation and evaluation of the soundness of the investment. *Id.* at 886-88.

104. *Mason Tenders*, 909 F. Supp. at 886-87.

105. *Id.* The court specifically stated that "[w]hile a trustee has a duty to seek independent advice where he lacks the requisite education, expertise and skill, the trustee, nevertheless, must make his own decision based on that advice." *Id.*

106. *Stabile*, *supra* note 15, at 362. The main goal behind ERISA § 1001(a) is to protect the pension plans and decrease the possible risk of losses. *Id.*

107. *Id.* at 366-68. Some of the original concerns were to protect retirement plans from employer overreaching and abuse. *Id.*

108. 29 C.F.R. § 2509.94-2(2) (2002). The Code of Federal Regulations states that "the maintenance by an employee benefit plan of a statement of investment policy designed to further the purposes of the plan and its funding policy is consistent with the fiduciary obligations set forth in ERISA section 404(a)(1)(A) and (B)." *Id.*



statutory language under 29 C.F.R. § 2509.94-2(2) states that working in accordance with an investment policy statement is "consistent" with ERISA's fiduciary obligations.<sup>109</sup> The court in *Liss* relied on that language to find the plan trustees liable for fiduciary breach due to the lack of an investment policy statement.<sup>110</sup>

Current statutory language supports the requirement that trustees understand investment dynamics. The Federal Regulations state that investment policy statements are written documents that provide the plan fiduciaries with guidelines and instructions "concerning various types or categories of investment management decisions."<sup>111</sup> It is clear from this language that plan trustees must have at least a basic understanding of investments in order to be able to follow the guidelines for implementation of the different types of investment management decisions.<sup>112</sup>

What is characteristic of the above-enumerated areas of trustee fiduciary breach is that the violations might have been avoided if the fiduciaries were adequately educated and skilled in fulfilling their responsibilities.<sup>113</sup> Better education would result in better performance of the retirement funds, and would also significantly limit trustee liability for possible breach. What is important is the underlying policy of the prudent person standard, which is concerned with the soundness of the decision making process, and not necessarily the outcome of the decision in question.<sup>114</sup> As the Eighth Circuit noted, citing *Katsaros*, "the prudent person standard is not concerned with results; rather it is a test of how the fiduciary acted."<sup>115</sup> The trustee is not, under this standard, evaluated with hindsight; the trustee is evaluated from the point in time when the decision was made.<sup>116</sup>

The fact that trustees' imprudent actions may not result in a financial loss for a plan thus does not always protect trustees from liability.<sup>117</sup> The Seventh Circuit addressed this issue in *Brock v. Robbins*.<sup>118</sup> In *Brock*, the plan trustees entered into a contract with a service provider, agreeing to pay ten million dollars after less than ten minutes of discussion.<sup>119</sup> The trustees never

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109. *Id.*

110. *Liss*, 991 F. Supp. at 296. The Court held that absence of an investment policy statement "coupled with the other acts and omissions by the trustees of these Funds, constituted a breach of fiduciary duty." *Id.*

111. 29 C.F.R. § 2509.94-2(2) (2002).

112. *Liss*, 991 F. Supp. at 296-97.

113. *Id.*

114. *Roth*, 16 F.3d at 917-18.

115. *Id.* (citing *Katsaros*, 744 F.2d at 279).

116. *Id.*

117. *Brock v. Robbins*, 830 F.2d 640, 648 (7th Cir. 1987).

118. *Id.* at 640.

119. *Id.* at 648.

evaluated the soundness of the contract.<sup>120</sup> The Seventh Circuit found that the plan trustees violated the prudent man standard and awarded injunctive relief despite the fact that the plan did not suffer any losses.<sup>121</sup> The court reasoned that "if the Secretary can prove to a court that certain trustees have acted imprudently, even if there is no monetary loss as a result of the imprudence, then the interests of ERISA are furthered by entering appropriate injunctive relief."<sup>122</sup> By allowing for this sort of liability, courts can deter potentially imprudent but honest trustees from engaging in transactions that can be harmful to retirement plans.<sup>123</sup>

Considering the reasons behind the frequent suits for trustee fiduciary breach, it is evident that trustee incompetence, especially in smaller pension plans, plays a major role in the litigation against trustees. Providing trustees with higher levels of expertise and sufficient information would benefit plan performance, and would cut down on the number of lawsuits involving these trustees.

## II. IN NEED OF EDUCATION: THE SAME EFFORTS IN A NEW DIRECTION

One potential solution to the problem of trustee responsibilities and expertise is providing trustees with adequate investment education. Some commentators have discussed investment education in connection with the inadequate diversification of defined contribution plans, and more specifically, 401(k) plans.<sup>124</sup> In that respect, the idea of education for the individual investor as a decision-maker who is in control of the funds is not a novel one.<sup>125</sup> What commentators agree on is that "investment education to employees should be encouraged."<sup>126</sup> At the same time, some have conceded that investment education is unlikely to affect the "employees' decisions with respect to investment."<sup>127</sup>

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120. *Id.*

121. *Id.*

122. *Id.* at 647.

123. *Id.*

124. Susan J. Stabile, *Pension Plan Investments in Employer Securities: More Is Not Always Better*, 15 YALE J. ON REG. 61, 85-86 (1998).

125. *Id.*

126. *Id.* at 86. See also Stabile, *supra* note 15, at 375 (noting that although regulations do not require an employer to provide investment education, employers have "recognized the desirability of providing some type of education to employees" who exercise primary control over the investments in their accounts). Professor Stabile also emphasizes that although employers try to provide investment education, they are cautious not to provide information that may amount to investment advice that carries the burden of fiduciary duty. *Id.*

127. Stabile, *supra* note 124, at 86.

One possible explanation for the lack of success of employee education with respect to plan diversification is the effect of context-dependence on the process of investment selection.<sup>128</sup> Professor Stabile argues that plan participant investment choices in defined contribution plans, and specifically 401(k) plans, are largely affected by the number of choices presented, by the way these choices are presented, and by the nature of the choices themselves.<sup>129</sup> In this respect, plan participants "making decisions in 401(k) plans do not, in fact, exercise meaningful control because of the influence exerted by employers and other fiduciaries."<sup>130</sup> Therefore, the ultimate decision-maker is not the plan participant, but the employer or the plan trustee who provides the different investment choices.<sup>131</sup>

Defined benefit plans, on the other hand, do not allow plan participants the broader decision-making powers characteristic of defined contribution plans.<sup>132</sup> The issue of context-dependence

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128. Stabile, *supra* note 15, at 378. The theory of context-dependence focuses on the behavior of a decision-maker and on the relationship between her and a particular choice in the presence of a number of alternative choices. *Id.* As Professor Stabile explains, according to classical choice theory the rational decision-maker will choose the alternative with the "highest value to her." *Id.* See also Muir, *supra* note 12, at 11-13 (noting the work of behavioral economists who recognize that investors do not always act in rational consideration of objective economic factors). Instead people very often rely on "heuristics to solve problems." *Id.* at 11. To demonstrate plan allocation choices, the author presents an experiment conducted by two economists, Professors Benartzi and Thaler. *Id.* at 12-13. The experiment involved two groups of employees enrolled in a benefit plan who were "asked to allocate their retirement contributions between stocks and bonds." *Id.* Both groups were given identical information on historical equity premiums, but the information was presented differently. *Id.* The results indicated that the investment decisions of the two groups differed depending on the way the information was presented. *Id.* "Two groups received charts showing the distribution of annual rates of return on a thirty-year investment." *Id.* The other group "received charts showing actual distribution of historic returns in one-year increments." Muir, *supra* note 12, at 12-13. The results showed a statistically significant difference. *Id.* The group that received the charts of distribution of one-year incremental rates invested less in equity securities than the other test group. *Id.*

129. Stabile, *supra* note 15, at 380-81. Professor Stabile offered an example in which "requiring company matching contributions to be invested in employer securities causes participants to direct a higher percentage of their self-directed funds there as well." *Id.* Observers refer to this phenomenon as the so-called endorsement effect, where "a participant interprets matches in employer securities as 'as an endorsement or as implicit investment advice.'" *Id.*

130. *Id.* at 386.

131. *Id.*

132. See Jefferson, *supra* note 14, at 610-12 (explaining that, under ERISA, the investment risk in defined benefit plans is placed on the employer and the trustees of the plan who are responsible for the investment decisions, and therefore for the ultimate plan performance).

does not exist in defined benefit plans because the plan trustees' control over the investment strategy of the plan is much more direct.<sup>133</sup>

It follows that in both defined benefit plans and defined contribution plans, plan fiduciaries and trustees tend to be the ultimate decision-makers.<sup>134</sup> At the same time, Part II of this Comment examined various incidents of litigation based on trustees' fiduciary breach with respect to smaller pension plans. As discussed, many of the problems arise, in the words of the Department of Labor, because "the responsible plan fiduciary either does not understand his role and responsibility in the selection and monitoring of service providers or exercises poor judgment because he does not have experience or an appropriate source of information concerning legal requirements and industry practices."<sup>135</sup>

What is missing from ERISA's requirements is a different direction of investment education. Education should be targeted towards the ultimate decision-maker.<sup>136</sup> Higher standards of fiduciary awareness and expertise should be required from plan trustees who have ultimate control over the investment process, and who also control the choices provided to plan participants in the form of defined benefit and defined contribution plans.<sup>137</sup> These goals may be achieved by targeted legislative amendments to ERISA, which the remainder of this Comment will describe.

What are the possible ways to better educate present and future plan trustees, especially trustees serving smaller plans? One possible solution may be to require individuals who assume positions as plan trustees to pass a minimum proficiency test. Such an approach may be helpful, especially with smaller plans where trustees are often volunteers whose investment knowledge

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133. *Id.*

134. *See supra* notes 124-32 and accompanying text (discussing the various degrees of investment control by plan fiduciaries).

135. Medill, *supra* note 9, at 490. One of the reasons why major employers and their pension plans do not encounter problems with service providers as often as smaller plans is that large employers often have sufficient resources to procure a number of in-house experts who can carefully select investment service providers. *Id.* at 489.

136. *See Stabile, supra* note 15, at 378-91 (explaining that participants in benefit plans may not always have control over those plans). The theory of context-dependence is at the center of the author's argument. *Id.* at 378-86. Even though 401(k) plan participants are supposed to act with knowledge and are believed to have full control over their investment decisions, their choices are to a large degree influenced, sometimes even manipulated, by the choices presented by their employers or the plan fiduciaries. *Id.*

137. *See supra* notes 135-36 and accompanying text (discussing the position of plan fiduciaries and their control over the investment decisions in defined benefit and defined contribution plans).

may be no different than that of the plan participants.<sup>138</sup> Financial service providers require various certifications for their employees.<sup>139</sup> Similarly, plan trustees who deal with investment advisors, and pension plan providers in general, should be able to converse in the language of their partners in the financial industry.

It can be argued that the requirement of some type of licensing or certification may increase the cost of administering the plan, which may deter smaller employers from providing such licensing or from offering plans served by licensed trustees. At the same time, however, employers should understand that with fiduciary lawsuits on the rise,<sup>140</sup> the cost of plan insurance may increase substantially.<sup>141</sup> The higher cost of plan insurance, together with the increased risk of lawsuits resulting in liability for plan trustees, should be a sufficient incentive to accept the small additional expense associated with licensing exams.

Another solution with broader application is the modification of section 404(c) of ERISA.<sup>142</sup> Limiting the protection of ERISA's

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138. See Chen, *supra* note 7, at C1 (explaining that some trustees are not aware of their duties and responsibilities).

139. Detailed information about the NASD and its corporate structure and profile is available at <http://www.nasdr.com/2220.asp> (last visited Feb. 13, 2004). The various types of licensing exams are administered by the NASD pursuant to the 1938 Maloney Act amendment of the Securities and Exchange Act of 1934. *Id.* NASD regulates the operations of the Nasdaq Stock Market, Inc. as well as the activities of more than 5,000 securities firms around the country. *Id.* All securities professionals willing to work for NASD-member firms must pass various examinations, administered by NASD, to demonstrate a sufficient level of competency in their intended field of employment. *Id.* Candidates are examined on subjects such as federal securities laws, SEC rules and regulations, the operation and interpretation of financial markets, and securities products and corporate financing. *Id.*

140. See Medill, *supra* note 9, at 470 (noting that as baby boomers age and begin to retire, a wave of litigation may result from their dissatisfaction with the performance of their pension plans). See Enron, *404(c) and the Personal Liability for Corporate Officers*, available at <http://www.reish.com> (copy on file with the author) (noting that the cost of fiduciary breach insurance is already on the rise, and if fiduciary litigation were to continue "it is almost certain that the premium costs for fiduciary insurance will increase significantly").

141. Enron, *supra* note 140.

142. 29 U.S.C. § 1104(C) (2000). Section 404(c) has been increasingly popular because it protects the employer from fiduciary liability arising from the imprudent investment decisions of the plan participants. *Employee Benefits Practice*, available at: <http://www.reish.com> (last visited Nov. 17, 2002). The statute provides in part that

[i]n case of a pension plan which provides for individual accounts and permits a participant or beneficiary to exercise control over the assets in his account, if a participant or beneficiary exercises control over the assets in his account. . . (A) such participant or beneficiary shall not be deemed to be a fiduciary by reason of such exercise, and (B) no person who is otherwise a fiduciary shall be liable under this part for any loss, or by reason of any breach, which results from such participant's or

safe harbor provision would raise the performance bar for plan fiduciaries and would require a higher level of vigilance and expertise.<sup>143</sup> With lesser protection from 404(c), employers will have to ensure the adequate performance of the pension fund if they are to protect themselves from possible suit for fiduciary breach.<sup>144</sup>

Additional support for narrowing the scope of 404(c) is available in the theory of context-dependence, which provides that plan participants are under the influence of the range and type of choices provided by the employer and the plan fiduciaries.<sup>145</sup> That finding, combined with the view that many plan trustees overseeing smaller plans do not perform adequately,<sup>146</sup> supports the idea that the limitation of 404(c) may, in fact, improve the performance of pension plan trustees.

### III. CONCLUSION

Drawing from its origins in the common law of trusts, ERISA requires pension plan trustees to act with prudence and diligence<sup>147</sup> in exercising their duty to protect plan participants' assets.<sup>148</sup> Many plan trustees, however, have been unable to meet this demanding legal responsibility.<sup>149</sup> As a result, plan trustees' inadequate performance has led not only to plan underperformance, but also to multiple lawsuits for fiduciary breach.<sup>150</sup>

Theory and practice show that any type of educational efforts should be directed towards the ultimate decision-makers in the investment of pension funds. Plan trustees, as these ultimate decision-makers, should be the true targets of educational efforts for higher standards of performance.<sup>151</sup>

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beneficiary's exercise of control.

29 U.S.C. § 1104(c) (2000).

143. *Employee Benefits Practice*, *supra* note 142.

144. *Id.*

145. *Stabile*, *supra* note 15, at 364.

146. *See generally* Chen, *supra* note 7, at C1 (noting that allegations of trustees' fiduciary breach are not limited to small plans, and that 401(k) plan trustees have been under increasing scrutiny). *See also* Liss, 991 F. Supp. at 296-97 (providing an example in which plan trustees were held liable for a number of violations ranging from a failure to hire an investment advisor to the failure to properly investigate the plan investments).

147. 29 U.S.C. § 1104(a) (2000). ERISA requires a fiduciary to exercise her duties "with care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity . . . would use . . ." *Id.*

148. *Stabile*, *supra* note 15, at 366.

149. *See* Chen, *supra* note 7, at C1 (describing various instances of fiduciary breach predicated on the plan trustee's inadequate performance).

150. *Id.* at C15

151. *Stabile*, *supra* note 15, at 364. The author's argument is that behavioral theory and context-dependence provide support for the proposition

The implementation of minimum level licensing exams will result in overall higher standards of performance for trustees, with benefits that would outweigh any incidental implementation costs for the plan. That result can be further boosted by narrowing the scope of section 404(c), which often fails to protect trustees, and codifies the illusory impression that defined contribution plan participants are solely responsible for their investment decisions.<sup>152</sup>

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that with respect to 401(k) and other defined contribution plans, plan participants are subject to influence and even manipulation by the plan fiduciaries. *Id.*

152. *Id.* at 398.